NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Four, 2020

Nedgroup Investments Flexible Income Fund

Performance to 30 September 2020	Fund Performance[1]	Stefi*110%
3 months	1.9%	1.0%
12 months	5.7%	4.9%

The fund concluded the year with a strong Q4 performance, outperforming its benchmark across both time periods. Local asset classes all performed well over the quarter, with local bonds the largest contributor to performance, followed by local property and preference shares. The strengthening of the ZAR relative to the USD detracted from performance, with the rand powering from R16.24/$ at the end of Q3 to R14.69/$ at the end of 2020.

Over the longer term the Nedgroup Investments Flexible Income Fund has delivered on its mandate to outperform cash with a predictable and low risk return profile. Its long-term performance is attributable to its philosophy of investing in a diversified range of fixed income asset classes, avoiding expensive asset classes and focusing on high credit quality.

Market Commentary

2020 was a year none of us will forget. The year was filled with surprises and uncertainty, including the escalation of the pandemic, the dire economic effect of lockdowns, the unprecedented extent of monetary and fiscal stimulus required, second waves of the pandemic greater than the first, and lastly a market rebound of magnitude few expected. The last quarter of the year proved as eventful, with the positive news of three effective vaccines, as well as the conclusion of the US election and Britain's separation agreement from the EU.

The COVID-19 case load across the world rose significantly over the quarter, topping previous highs both locally as well as in Europe and the US. This saw lockdowns reimplemented, continuing to burden both the global and local economies. Markets however have been willing to look through the near-term weakness, rather focusing on the positive vaccine news and continued large-scale monetary and fiscal stimulus. Global equity markets soared this quarter, with the MSCI World Index returning 14.1% for the quarter, and 16.5% for the year. Similarly, the MSCI EM index returned 19.6% for the quarter and 18.5% for the year, while the JSE/FTSE All Share index returned 9.8% for the quarter and 7.0% for the year.

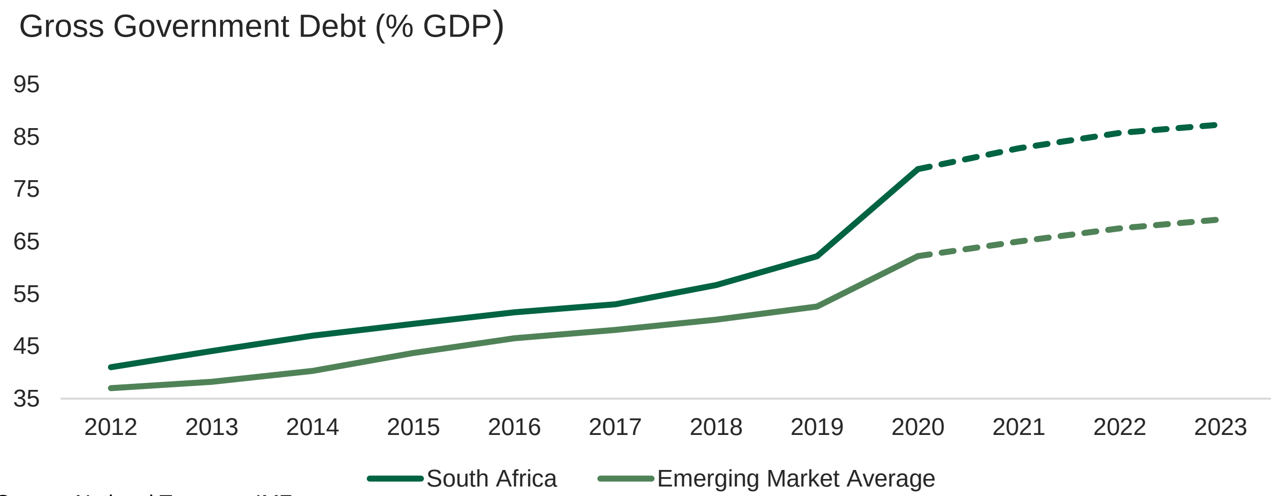
Global Markets
The extent of global monetary and fiscal stimulus was unprecedented in 2020, and global central banks have injected more than $6 trillion of liquidity into world financial markets, mostly in the form of quantitative easing. With the US leading the way in the quantity of stimulus performed, the US dollar continues to weaken as its supply increases. This has led many investors to move into real assets such as global equity and commodities, as well as the latest "store of value" bitcoin, which seems to be hitting new historic highs almost daily.

Local Markets
On the local front, we have also seen large levels of support, with the government injecting about R500bn worth of stimulus into the economy in 2020. This includes the MPC cutting interest rates by 3% since the beginning of the year, taking our repo rate to a historically low 3.5%. The last cut was performed in July, and the MPC has signaled little to suggest that, in the absence of any material changes, they are willing to cut more. With local inflation well below the midpoint of the target band, and the rand as strong as it is now, one can make a case for additional cuts. However, the MPC believe that the front-loaded cuts have provided significant & ongoing stimulus, and that their forward growth and CPI forecasts signal further cuts as unnecessary. Unlike many other central banks (surprisingly, including those of other emerging markets), the SARB has remained conservative in respect of QE, and have only intervened in conservative bond purchases in the market to maintain liquidity.

[1] Net return for the Nedgroup Investments Flexible Income Fund, A class. Source: Morningstar (monthly data series).

Bond purchases for the year by the SARB totaled about R41bn, but this has largely slowed down and was very front loaded in the crisis.

Local equity and the ZAR have benefitted from the 'risk-on' global backdrop over the last few months, with the rand reaching levels we thought we would never see again, given the deteriorating fundamentals of South Africa. At the peak of the crisis the rand hit R19.35 to the US dollar and recovered to an incredible R14.69 to the US dollar by year end. While local bonds have also benefitted from this 'risk-on' environment, with the ALBI returning 6.7% for the quarter and 8.7% for the year and linkers returning 5% for the quarter and 4.1% for the year, they are still pricing in significant credit risk and offering a yield that remains attractive in a global low yield environment. As attractive as these yields are, we remain cautious as, come February, the budget will again remind us just how desperate a debt position South Africa finds itself in. The below depicts just how much more indebted South Africa is relative to other emerging markets.



Source: National Treasury, IMF

Other local assets that benefitted from the global backdrop in Q4 2020 include local property and preference shares that returned 22.2% and 13.8% for the quarter respectively. These strong returns were however not enough to compensate for the poor year experienced by both asset classes, delivering -33.7% and -11.3%, respectively.

The continued weakening of the US dollar, subdued global bond yields and strong equity markets seems to be a very consensus view for the markets for 2021. It is difficult to disagree with this view, as governments and global central banks will likely continue this significant stimulus. At the Federal Open Market Committee (FOMC) in December the committee announced that the current pace of asset purchases (about $120bn a month) will continue until "substantial further progress" towards inflation and employment goals have been achieved. An additional fiscal stimulus package is also expected in the coming weeks as Biden takes over, in addition to the $900bn package that was announced late last year. Not only are these interventions likely, but they are also necessary, as they are keeping bonds yields at superficially low levels. The highly indebted global system simply cannot afford for bond yields to move up significantly, the system is too fragile. With inflation subdued, and well below the mid target range for a significant period, the Fed have scope for additional quantitative easing (QE) and likely will continue to do so. Should inflation return to the global market (and expectations for a higher inflation environment are increasing), markets will find themselves in a precarious position, as either the repercussion of rising bond yields & fiscal consolidation play out, or we find ourselves in a new paradigm of yield curve control.

Current positioning and outlook

- Low Duration

As at the end of Q4 2020, SA duration is 0.68 years in nominal bonds (Q3: 0.66) and 0.49 years in Inflation Linked Bonds (Q3: 0.49). We continue to predominantly hold the SA 10-year nominal bond (R2030) and 5-year SA Inflation-Linked Bond (I2025). Yields at current levels remain attractive, but the risk to the SA fiscus has shifted fundamentally higher due to the crisis. We will therefore look to maintain a relatively conservative position to bonds, always managing this alongside its natural hedge, foreign currency.

- High Credit Quality

The portfolio has a high degree of credit quality. Our credit process has historically shielded from capital loss due to credit events in SA and we are confident in our ability to protect investor's capital in the fixed income space.

Generally, corporate balance sheets have deteriorated because of the crisis and continue to remain challenged as long as lockdowns and fears around COVID-19 remain. We retain our preference for a diversified portfolio of senior bank debt and low risk / high grade corporates.

- Convertible Bonds

The position in Royal Bafokeng Convertible Bonds continue to be a top contributor to the fund's performance, fuelled by the rally in commodity prices. We believe that convertible bonds can provide an inflation hedge, and in our search to add exposure to this asset class, purchased MAIL.RU and Sappi convertible bonds. MAIL.RU bonds offer us a positive USD yield, and upside participation in a low-geared, technology corporate. The position in Remgro Convertible Bonds have offered a high degree of credit quality at a significant yield pickup over its life in the fund and are maturing this quarter.

- Property

The fund currently has 2.47% (Q3: 2.49%) exposure to domestic property. We have maintained a conservative exposure and trimmed some positions into strength over the quarter to avoid heightening exposure. The levels of debt and reduced economic activity make the yield outlook highly uncertain, and we continue to selectively allocate to names who are not highly leveraged.

- Preference Shares

Preference Shares exposure is conservative at 2.61% (Q2: 2.35%), with the majority in the Big 4 banks. Given the systemic importance of the banks, we believe that the SARB will do everything possible to help them navigate the crisis. We are comfortable with the capital value and the post-tax yield remains very attractive in this environment.

- Offshore Bonds & Money Market

The fund maintains an exposure to offshore bonds and money market instruments at 18.3% where a very attractive yield pickup over domestic assets is available while maintaining a high degree of credit quality. Our FX exposure is around 8.6%; this was increased over the quarter due to the aggressive strengthening of the rand. The exposure allows us to participate in rand weakness, should the rand revert to fairer valuation levels.

Summary and Conclusion

It's likely that 2021 will continue to be characterized by negative real rates, fiscal expansion and QE. Allocations to real assets in this environment make sense and it's for this reason that we continue to look for opportunities in convertible bonds, inflation linked bonds and property. Despite this view for 2021, one gets the feeling that markets are on edge and particularly sensitive to news around inflation and stimulus, so we expect a lot of volatility around these trends. This volatility will likely be augmented by the fact that so much positive news is priced in already. We believe it's important in this environment to remain nimble and take advantage of sharp moves, ensure the portfolio is well diversified and, importantly, look to reassess our views regularly in this fast-paced global environment. 2020 has taught us to expect the unexpected after all.

Disclaimer

WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

OUR TRUSTEE

The Standard Bank of South Africa Limited is the registered trustee.
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HOW ARE OUR FUNDS PRICED

Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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